No. 2512

In the United States Circuit Court of Appeals

for the Ninth Circuit

THE WASHINGTON TRUST COMPANY,
Petitioner and Applicant,

vs.

EDWARD H. CHAVELLE, as Trustee of the Estate of Washington Steel & Bolt Company, a Corporation, Bankrupt,
Respondent and Appellee.

PETITIONER'S AND APPELLANT'S (THE WASHINGTON TRUST CO.) BRIEF ON APPEAL.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES, FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION.

DANSON, WILLIAMS & DANSON,
JAMES B. MURPHY,
CARL KINCAID,
Counsel for Petitioner and Appellant.

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STATEMENT OF CASE.

This is an appeal from two orders or decisions rendered on October 16, 1914, by the United States District Court for the Western District of Washington, Northern Division, sitting in bankruptcy, in one of which the said court decreed that certain first mortgage bonds of the Washington Steel &

Bolt Company, Bankrupt, were valid obligations against the said bankrupt, and certain other bonds were void and did not constitute an existing obligation against the said bankrupt estate, and in the other of the said two orders directed the trustee to sell the entire estate of the bankrupt free and clear of all incumbrances.

The evidence shows the following facts: (All references to pages refer to the printed record.)

The Washington Steel & Bolt Company, a private corporation, now bankrupt, when it was solvent and doing business, on or about and under the date of September 1, 1908, executed a bond issue totaling the sum of $200,000.00, and under the same date (although its execution was not completed until September 9, 1908, as shown by the acknowledgment) the said Washington Steel & Bolt Company executed a trust deed of its real and personal property to the Washington Trust Company to secure the said bond issue. This trust deed was timely filed and recorded in the auditor's office of the proper county in this state. The issue consisted of a series of 750 bonds of different denominations. Each bond was in the form of a negotiable promissory note. It was made payable to the bearer or registered holder, and stated that it was one of a series of 750 like bonds, and that it was secured by the trust deed, and further stated that $75,000.00 in amount of the bonds should be issued and placed upon the market upon the execution and delivery of the trust deed and the balance

should be placed upon the market at the direction of the trustees of the company. (Record, p. 283.) There was no limitation in the bonds as to the use of the money derived therefrom, and no limitation in the bonds as to the price for which they should be sold. Each bond further stated that it should pass by delivery. Each bond was signed by the officers of the company and bore the corporate seal of the company. Of this issue, $62,000 in amount was certified by the Washington Trust Company, the trustee named in the deed, as to their authenticity, and negotiated by the company. The balance of the issue still remains in the hands of the Washington Trust Company as trustee.

The board of trustees of the mortgagor, in order to protect all bondholders and give credit to the bonds and assurance to those who might take them, passed a resolution on September 1, 1908, wherein it resolved that the mortgage should secure the payment of the principal and interest of said bonds equally and ratably without priority or distinction, irrespective of the date of issuance of the same, and further determined by said resolution and had incorporated in the trust deed that each of the bonds should be certified by the trustee, to-wit: the Washington Trust Company, and that such certificate should be conclusive proof that such bond was secured by said trust deed. (Exhibit 2, Trust deed, p. 282. Exhibit 27, Resolution of the Board of Trustees of Septemper 1, 1908, p. 261.)

The Washington Steel & Bolt Company at the

time it was providing for these bonds was a young concern completing and extending its manufacturing plant, and needed money to meet pressing demands. There was some delay in issuing the bonds. Its President, A. McPhaden, to enable the said company to continue its work, advanced to it certain money. When the bonds were ready for market Mr. McPhaden took bonds in the sum of $23,000.00 for this money he had advanced. While the bonds were silent upon the point, the mortgage provided that the bonds should not be sold for less than 95 cents on the dollar. The company had passed a resolution allowing a 5 per cent commission for selling the bonds. (Ex. 27.) In delivering bonds to Mr. McPhaden for the money advanced, the company allowed him to take them at 95 cents on the dollar, the minimum price, and also allowed a commission of 5 per cent, or what would be equivalent to a commission of 5 per cent had the bonds been sold direct to a third person. Mr. A. G. Pike, the secretary and manager of the company, had also advanced money in like manner, and for these advances he received bonds in the sum of $2900.00. (pp. 182.) The bonds in each case were actually delivered by the company immediately upon their execution. These bonds were used by McPhaden and Pike as their property from that time forward. Mr. McPhaden, the president of the company, who had offices in Spokane, Washington, was the sole agent for the sale of the bonds. He received no salary as president, but pursuant to said

resolution was entitled to receive a 5 per cent commission for the sale of the bonds (pp. 179, 183). Finding it difficult to sell the bonds, he borrowed some money from certain friends and acquaintances and turned it in to the company, received bonds therefor and then paid his friends in bonds, which was one way of selling the bonds of the company (pp. 182). After the bonds were issued and while they were being thus disposed of by Mr. McPhaden for the company, he advanced the money thus procured to the company and received in lieu thereof bonds in the amount of $11,000.00, which were delivered to him at 95 cents on the dollar, less 5 per cent selling commission, which, together with the $23,000.00 in bonds he had previously received, made a total of $34,100.00 issued to him or passing through his hands. (See testimony of McPhaden p. 183.) All these transactions took place soon after the bonds were issued.

All the bonds were certified by the Washington Trust Company from time to time and delivered to McPhaden at the request of the Washington Steel & Bolt Company, and upon receipt of copies of the minutes of the meetings of the Board of Trustees authorizing delivery. (See Exhibits 29, 30, 32, 34, 35, 36, pp. 266 et seq.)

Some time during March or April of 1909 (McPhaden did not remember just when) the Washington Steel & Bolt Company, being in need of money, sought to negotiate a loan of the Bank of Montreal at Spokane, Washington. The Bank of

Montreal refused to loan the amount sought unless the bonds were put up as collateral (p. 179). After some negotiation and the viewing of the plant at Edmonds, Snohomish County, Washington, the bank finally agreed to loan the company $20,000.00. To obtain this loan from the Bank of Montreal the Washington Steel & Bolt Company procured four notes signed by McPhaden and Pike to it, totaling the sum of $20,000.00, and procured from McPhaden $20,000.00 of the bonds issued to him and from Pike $2900.00 in bonds issued to him, and they were thus delivered and pledged to the Bank of Montreal as security for the loan (pp. 179 and 180). This money was paid by the Bank of Montreal to the Company at different times as its need required, and the notes and bonds were delivered to the Bank of Montreal on behalf of the company from time to time, as the money was advanced. The indebtedness to the Bank of Montreal has never been paid, and there is still due upon said indebtedness the sum of $20,000.00, together with interest thereon at the rate of 8 per cent per annum, from the 23rd day of December, 1910 (p. 219). Both McPhaden and Pike are insolvent. All the money was loaned by the Bank of Montreal to the Washington Steel & Bolt Company, and all of said security was given by the said company to the Bank of Montreal under the agreement that the bank should be given this security for the money loaned. Every cent of the

money loaned was used by the company in its business (p. 190).

Shortly after March 20, 1911, the Washington Steel & Bolt Company, being in default in the interest due on the said loan, and having an overdraft with the bank, and to prevent action by the bank and induce it to grant an extension of the said loan, which was payable on demand, and the interest due thereon, pursuant to a resolution of its Board of Trustees, dated March 20, 1911, pledged $25,000.00 of bonds with the bank in addition to those already pledged by McPhaden and Pike, individually, as collateral for the payment of the principal and interest of the loan. These bonds were delivered to the Bank of Montreal by the Washington Trust Company on an order given it by the Washington Steel & Bolt Company. (See Exhibits 37, 38, 39; pp.275, 276, 277 and p. 180 Record.)

These bonds came direct from the Washington Steel & Bolt Company, and are held as collateral to secure the payment of said indebtedness of $20,000.00 and interest. The balance of the bonds obtained by McPhaden were disposed of to various persons, and the present holders of the bonds issued by the company are as follows:

C. F. Chapin	$2,500.00
Meta McElroy	2,000.00
J. H. Osborne	7,000.00
Thos. S. Burley	2,600.00
Bank of Montreal	47,900.00
Total	$62,000.00

The bonds held by the Bank of Montreal are made up, as above stated, as follows:

Bonds of A. G. Pike	$ 2,900.00
Bonds from McPhaden	20,000.00
Bonds received direct from the company as collateral security	25,000.00
Total	$47,900.00

The outstanding bonds had attached interest coupons, the interest being payable semi-annually. Interest was paid upon all outstanding bonds, except those held by the Bank of Montreal, to March 1, 1911. The interest coupons becoming due September 1, 1911, were not paid. The interest on the bonds held by the Bank of Montreal was paid to September 1, 1910 (pp. 222, 223 and 219).

On or about September 13, 1911, the Washington Steel & Bolt Company was declared a bankrupt, and soon thereafter Edward H. Chavelle was appointed its trustee in bankruptcy. Default occurred in the payment of interest upon the bonds outstanding, and a cause of action was matured and the trust deed became subject to foreclosure. Upon the application and request of the holders of the bonds, the Washington Trust Company as trustee in said deed filed a petition in the bankruptcy proceedings in which it prayed for leave to foreclose its mortgage. Testimony was taken in support of this petition and the referee in bankruptcy, on December 19, 1912, granted the prayer of the petitioner, but imposed the condition that the

Washington Trust Company should pay into the registry of the bankruptcy court, for the defrayal of the expenses of the administration of the bankrupt's estate, the sum of $1,200.00. The Washington Trust Company refused to comply with the condition imposed by the order of the referee and obtained a review of this order by the District Court. The District Court, upon review, vacated the order made by the said referee, and being of the opinion that if there was any question as to the validity of the trust deed or bonds such questions could be more easily and less expensively determined in the bankruptcy court, on the 3rd day of March, 1913, in its order referring the matter back to the referee, the court ordered that:

"And it is hereby further ordered that when such questions have been determined, the trustee must elect whether he will administer the equity of redemption for the benefit of the general creditors, provided said mortgage and bonds are held valid, or surrender the mortgaged property to the mortgagee for foreclosure."

This order was never appealed from but ever remained in full force and virtue.

The referee again heard the testimony and on May 15, 1913, filed an opinion in which he held that the validity of the mortgage and bonds had not been established by the evidence offered and on June 16, 1913, entered an order upon that finding denying the Washington Trust Company any relief and holding the bonds and mortgage null and void. The correctness of this order, upon the petition of the Washington Trust Company, was reviewed by

the District Court, and on September 22, 1913, the District Court rendered a memorandum opinion holding that the mortgage was a binding and valid lien upon all the real property of the bankrupt and upon a portion of the personal property, and holding it void as to the stock in trade upon the ground that permission was given in the mortgage to the mortgagor to sell this stock in the ordinary course of business without accounting to the mortgagee for the proceeds and expressed an opinion that all the bonds, concerning which testimony was offered, were binding obligations upon the company, but as the evidence was not clear as to the amount due upon these obligations, did not adjudicate their validity, and in accordance with the memorandum opinion, on the 14th day of February, 1913, the District Court entered a final order adjudging the mortgage valid and remanding the cause to the referee to take proof to ascertain the status of each of the bonds issued under the mortgage and the amount due and owing upon each of said bonds. (pp. 30, 39-52). Further testimony was taken and the referee again, on June 29, 1914, filed his report, which was not in the nature of Findings and Conclusions, upon the matters mentioned in the order remanding the cause, but rather an argument against the views upon the law expressed by the District Court in its memorandum decision holding the mortgage valid. The cause was again referred back to the referee with specific instructions to make Findings of Fact and Conclusions of

Law, and an order or judgment upon the same, and under date of July 20, 1914, the referee entered Findings of Fact, Conclusions of Law and a judgment holding all the bonds issued under the said mortgage void, rejecting the claim of the Washington Trust Company and expunging it from the list of claims upon record in the bankruptcy proceedings. The Findings of Fact and Conclusions of Law made by the referee appears in the record, but will not be set out here, as they are lengthy and because the District Court considered the testimony and passed upon the case *de novo* and without reference to the findings of fact of the referee, but suffice it to say here that the referee held all th bonds void in the hands of McPhaden and Pike and all subsequent holders (pp. 55 to 74 inclusive). Exceptions were duly taken to the Findings and Conclusions and Judgment of the referee.

There had also, prior to this hearing, been filed on behalf of the trustee in bankruptcy, a petition to sell this property free of all encumbrances and on the 28th day of July, 1914, eight days after the judgment was entered declaring the bonds void, the referee entered a judgment and order upon the same testimony which he had heard touching the validity of the mortgage, authorizing and directing the trustee in bankruptcy to sell the property for cash free of encumbrances. (See pp. 91 and 102.)

A petition to review the judgment entered on the 20th day of July, holding the bonds void, was duly filed and there was also filed a petition to re-

view the order of the referee directing a sale of the property for cash free of encumbrances. (See pp. 74 and 105.) These two petitions for review were considered by the District Court as one, were argued together and passed upon at the same time by the Judge of the District Court. The District Court would not take up, consider and pass upon separately the Findings, Conclusions and Decree of the Referee, and refused to make Findings himself, but perused and considered the testimony and rendered a memorandum decision thereon, and made only Findings of Fact as they were set forth in his opinion.

On September 15, 1914, he rendered an opinion upon the petition for review, in which he held that all the bonds, except $25,000.00 held by the bank, were valid in the hands of the present holders. His views upon that point were clearly expressed in the following language in the opinion:

"From a consideration of all of the evidence presented, I am of the opinion that the $23,400.00 of bonds issued to McPhaden, and the $2,900.00 of bonds issued to Pike, issued for past indebtedness to Pike and McPherson for monies advanced by them to the corporation long prior to the date of the bonds, and transferred to the Bank of Montreal as collateral security for money paid to the company, are liabilities to the extent of the advances. There were also regularly issued: To C. F. Chapin, $2,500.00; Meta McElroy, $2,000.00; J. H. Osborne, $5,900.00; and Thomas S. Burley, $2,600.00. The bonds issued to these last named parties were upon considerations paid by these several parties to McPhaden, who paid that money to the Washington Steel & Bolt Company, which he was repre-

senting, and it was used by this company in the regular course of business, and all benefits arising from such payments accrued to the corporation. These several parties havinfi thus paid their money upon the faith and credit of these bonds and the mortgage, should not now be deprived of the benefits accruing by reason of such security, after the corporation had used their money, some of which, perhaps, now representing some of the assets. The contention that the bonds are void because of the fact that a commission was paid to the person negotiating the bonds cannot be well founded as against the parties who paid ninety-five cents on the dollar, which the testimony shows these several parties did, except as to the bank holding the bonds issued to McPhaden and Pike as collateral security.

"The $25,000.00 bonds issued to the Bank of Montreal as collateral security, I do not think are a valid claim. The bonds were delivered without any authority, either fact or law. There is no testimony before the court that the delivery of these bonds was ever authorized in a legal manner, and if a proper resolution had been passed, the authority under which the bonds were executed did not comprehend the issuance of bonds for any such purpose.

"I think the findings and conclusions of the referee should be modified in so far as they relate to the $23,400.00 of bonds issued to McPhaden, and the bonds issued to C. F. Chapin, Meta McElroy, J. H. Osborne, Thomas S. Hurley and Pike. I think that the property should be sold, and the proceeds applied to the payment of the claims of the Bank of Montreal, to the extent of its interest in the McPhaden and Pike bonds held as collateral, and also the bonds of Chapin, McElroy, Osborne and Burley, les such proportion of the expenses as should be paid by said interests in this bankruptcy proceeding, and the balance, if any, less expenses of administration, to be distributed among the gen-

eral creditors, as provided by the Bankruptcy Act.

"Let an order be presented.

"JEREMIAH NETERER, Judge."

After the rendition of this opinion, the District Judge changed his views somewhat as to the law and became of the opinion that the bonds ($23,000 to McPhaden and $2,900 to Pike) were void in the hands of the original takers because they were negotiated for a sum less than 95 cents on the dollar, but that the $11,100 in bonds afterwards acquired by McPhaden were valid obligations in the hands of McPhaden because he had paid therefor as the bonds were received, and also became of the opinion that the bonds were non-negotiable, and if void in the hands of the original takers were void in the hands of all subsequent purchasers. He undertook then, with little or no guide in the evidence, to find and hold valid the $11,100 in bonds acquired by McPhaden and to find and hold void the remainder of the bonds issued, and later, on October 16, 1914, entered a judgment holding $1,000 of the bonds held by Chapin and all the bonds held by McElroy and Osborne valid claims and secured by the mortgage and ordered the property sold and the proceeds applied to the payment of these bonds, and adjudged that the bonds held by the Bank of Montreal, $1,500.00 of the bonds held by Chapin and all the bonds held by Thomas F. Burley were void and of no effect, and also upon the same day confirmed the order of the referee authorizing and directing a sale of the mortgaged

property for cash free of encumbrances. (See pp. 110 and 111.)

This appeal is taken from that part of the judgment rendered holding the bonds in the hands of the Bank of Montreal and Thomas F. Burley and $1,500.00 of the bonds held by C. F. Chapin void, and from the order confirming the order of the referee directing a sale of the property free from encumbrances and denying the right of the persons whose bonds were held valid to use such bonds in answering their bid.

Our contentions in reference to the validity of the bonds are as follows:

I.

(a) That the bankrupt, regardless of the question of the negotiability of the bonds, is estopped from questioning the validity of the bonds first pledged to the Bank of Montreal, because the bankrupt itself procured the pledge of these bonds for a loan of $20,000.00, which it received and the fruits of which it has used and retained.

(b) That the $25,000.00 in bonds later acquired as additional collateral by the Bank of Montreal are valid, because, in addition to the reasons set forth by us as sustaining the validity of all the bonds, the bankrupt was not prohibited from pledging its bonds as additional security for an existing indebtedness and at the same time restraining a foreclosure on the mortgage and covering an overdraft with the bank. They were pledged in the ordinary course of business, more than four months

prior to the filing of the petition in bankruptcy, and therefore could not be questioned by the trustee.

(r) The bonds held by Chapin and Burley are valid because they were duly and regularly issued, paid for, were negotiable and were in the hands of innocent purchasers for value.

II.

That the court erred in confirming the order of the sale of the property for cash before the validity of the mortgage bonds was finally determined, and in refusing to adopt provisions 21 and 22 of a proposed decree, which permitted the bondholders or the Washington Trust Company, as trustee for the bondholders, after first paying in sufficient money to cover such portion of the costs of the bankruptcy proceedings as should be borne by the bondholders, to use their bonds in answering bids made by them for the mortgaged property.

III.

That the court erred in undertaking itself to foreclose a mortgage and direct a sale of the property and in not requiring the trustee to elect whether he would administer upon the equity of redemption for the benefit of general creditors or surrender the mortgaged property to the mortgagee for foreclosure.

SPECIFICATIONS OF ERRORS.

I.

The District Court of the United States for the Western District of Washington, Northern Division, erred in holding that the bonds amounting to $22,-

900.00 held by the Bank of Montreal and taken by it as security for the payment of the loan made to the Washington Steel & Bolt Company, at the time of the making of said loan, void, and in refusing to hold each of said bonds valid and secured by the trust deed given for that purpose. The said court further erred in refusing to adopt Paragraph IV of the provisions for decree proposed by the Washington Trust Company.

II.

The said court erred in holding that the bonds of the Washington Steel & Bolt Company afterwards taken by the Bank of Montreal, amounting to the par value of $25,000.00, were void, and in refusing to hold the same valid and in refusing to adopt as part of its decree or order Paragraph VI of the proposed provisions of the Washington Trust Company.

III.

The said court erred in holding $1,500.00 par value of the bonds of the Washington Steel & Bolt Company held by C. F. Chapin void and of no effect, and in failing and refusing to hold the said bonds valid and in failing and refusing to adopt Paragraph X of the provisions for decree proposed by the Washington Trust Company.

IV.

The said court erred in holding in effect that the bonds of the Washington Steel & Bolt Company held by Thomas F. Burley were null and void and in failing and refusing to hold the said

bonds amounting to the par value of $2,600.00 valid, and in failing and refusing to adopt and incorporate in its decree Paragraph XII proposed by the Washington Trust Company as an appropriate part of the order of said court.

V.

The said court erred in ordering and directing a sale of the property of the Washington Steel & Bolt Company, and in refusing the bond holders of the said company the right or privilege to use in bidding for said property their bonds in proportion to the net amount of the proceeds of said sale which would ultimately be turned back to any bondholder as a bidder at said sale, and in failing and refusing to adopt Paragraph XXI of the provisions for decree proposed by the Washington Trust Company.

VI.

The said court erred in refusing to grant the Washington Trust Company leave to foreclose its mortgage according to the prayer of its petition, and in refusing to require the trustee in bankruptcy, after the mortgage was held valid, to elect whether he would administer upon the equity of redemption of the property covered by said mortgage for the benefit of general creditors, or surrender the property for mortgage foreclosure.

VII.

The said court erred in the order entered October 16, 1914, in directing that there should be deducted from the proceeds of the sale such propor-

tion of the expenses and costs as should be paid by the interests represented by the Washington Trust Company.

VIII.

The said court erred in refusing to sustain the exceptions of the Washington Trust Company to the order entered by the referee on the 28th day of July, 1914, and erred in confirming said order.

IX.

The said court erred in holding in its final order certain of the bonds invalid and void, which it pronounced valid in its memorandum opinion.

X.

The said court erred in refusing to specifically or at all sustain exception No. 1 of the Washington Trust Company to the referee's report and findings.

XI.

The said court erred in refusing specifically, or at all, sustain exception No. 2 of the Washington Trust Company to the referee's report and findings.

XII.

The said court erred in refusing to specifically, or at all, sustain exception No. 3 of the Washington Trust Company to the referee's report and findings.

XIII.

The said court erred in refusing to specifically, or at all, sustain exception No. 4 of the Washington Trust Company to the referee's report and findings.

XIV.

The said court erred in refusing to specifically, or at all, sustain exception No. 5 of the Washington Trust Company to the referee's report and findings.

XV.

The said court erred in refusing to specifically, or at all, sustain exception No. 6 of the Washington Trust Company to the referee's report and findings.

XVI.

The said court erred in refusing to specifically, or at all, sustain exception No. 7 of the Washington Trust Company to the referee's report and findings.

XVII.

The said court erred in refusing to specifically, or at all, sustain exception No. 8 of the Washington Trust Company to the referee's report and findings.

XVIII.

The said court erred in refusing to specifically, or at all, sustain exception No. 9 of the Washington Trust Company to the referee's report and findings.

XIX.

The said court erred in refusing to specifically, or at all, sustain exception No. 10 of the Washington Trust Company to the referee's report and findings.

XX.

The said court erred in refusing to specifically, or at all, sustain exception No. 11 of the Washing-

ton Trust Company to the referee's report and findings.

XXI.

The said court erred in refusing to specifically, or at all, sustain exception No. 12 of the Washington Trust Company to the referee's report and findings.

XXII.

The said court erred in refusing to specifically, or at all, sustain exception No. 13 of the Washington Trust Company to the referee's report and findings.

XXIII.

The said court erred in refusing to specifically, or at all, sustain exception No. 14 of the Washington Trust Company to the referee's report and findings.

XXIV.

The said court erred in refusing to specifically, or at all, sustain exception No. 15 of the Washington Trust Company to the referee's report and findings.

XXV.

The said court erred in refusing to specifically, or at all, sustain exception No. 16 of the Washington Trust Company to the referee's report and findings.

XXVI.

The said court erred in refusing to specifically, or at all, sustain exception No. 17 of the Washington Trust Company to the referee's report and findings.

XXVII.

The said court erred in refusing to specifically, or at all, sustain exception No. 18 of the Washington Trust Company to the referee's report and findings.

XXVIII.

The said court erred in refusing to specifically, or at all, sustain exception No. 19 of the Washington Trust Company to the referee's report and findings.

XXIX.

The said court erred in refusing to specifically, or at all, sustain exception No. 20 of the Washington Trust Company to the referee's report and findings.

XXX.

The said court erred in refusing to specifically, or at all, sustain exception No. 21 of the Washington Trust Company to the referee's report and findings.

XXXI.

The said court erred in refusing to specifically, or at all, sustain exception No. 22 of the Washington Trust Company to the referee's report and findings.

XXXII.

the said court erred in failing and refusing to specifically, or at all, sustain the first ground of error assigned by the Washington Trust Company in its petition for review, upon which the District Court passed in rendering its said decision.

XXXIII.

The said court erred in failing and refusing to specifically, or at all, sustain the second ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XXXIV.

The said court erred in failing and refusing to specifically, or at all, sustain the third ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XXXV.

The said court erred in failing and refusing to specifically, or at all, sustain the fourth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XXXVI.

The said court erred in failing and refusing to specifically, or at all, sustain the fifth ground of error assigned by the Washington Trust Company in its ePtition for Review, upon which the District Court passed in rendering its said decision.

XXXVII.

The said court erred in failing and refusing to specifically, or at all, sustain the sixth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the

District Court passed in rendering its said decision.

XXXVIII.

The said court erred in failing and refusing to specifically, or at all, sustain the seventh ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court pased in rendering its said decision.

XXXIX.

The said court erred in failing and refusing to specifically, or at all, sustain the eighth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XL.

The said court erred in failing and refusing to specifically, or at all, sustain the ninth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XLI.

The said court erred in failing and refusing to specifically, or at all, sustain the tenth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XLII.

The said court erred in failing and refusing

to specifically, or at all, sustain the eleventh ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XLIII.

The said court erred in failing and refusing to specifically, or at all, sustain the twelfth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XLIV.

The said court erred in failing and refusing to specifically, or at all, sustain the thirteenth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XLV.

The said court erred in failing and refusing to specifically, or at all, sustain the fourteenth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XLVI.

The said court erred in failing and refusing to specifically, or at all, sustain the fifteenth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the

District Court passed in rendering its said decision.

XLVII.

The said court erred in failing and refusing to specifically or at all sustain the sixteenth ground of error assigned by the Washington Trust Company in its petition for Review, upon which the District Court passed in rendering its said decision.

XLVIII.

The said court erred in failing and refusing to specifically, or at all, sustain the seventeenth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

XLIX.

The said court erred in failing and refusing to specifically, or at all, sustain the eighteenth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

L.

The said court erred in failing and refusing to specifically, or at all, sustain the nineteenth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LI.

The said court erred in failing and refusing to

specifically, or at all, sustain the twentieth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LII.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-first ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LIII.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-second ground of error assigned by the Washington Trust Company in its Petition of Review, upon which the cision.

LIV.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-third ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said de-

LV.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-fourth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LVI.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-fifth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LVII.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-sixth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LVIII.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-seventh ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LIX.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-eighth ground of error assigned by the Washington Trust ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LX.

The said court erred in failing and refusing to specifically, or at all, sustain the twenty-ninth

ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LXI.

The said court erred in failing and refusing to specifically, or at all, sustain the thirtieth ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LXII.

The said court erred in failing and refusing to specifically, or at all, sustain the thirty-first ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LXIII.

The said court erred in failing and refusing to specifically, or at all, sustain the thirty-second ground of error assigned by the Washington Trust Company in its Petition for Review, upon which the District Court passed in rendering its said decision.

LXIV.

The said court erred in refusing to incorporate in its caid order and decree upon review Paragraph I of the provisions requested by the Washington Trust Company to be incorporated in the order or decree of the court.

LXV.

The said court erred in refusing to incorporate in its said order and decree upon review Paragraph II of the provisions requested by the Washington Trust Company to be incorporated in the order or decree of the court.

LXVI.

The said court erred in refusing to adopt Paragraph III of said provisions.

LXVII.

The said court erred in refusing to adopt Paragraph V of said provisions.

LXVIII.

The said court erred in refusing to adopt Paragraph VII of said provisions.

LXIX.

The said court erred in refusing to adopt Paragraph VIII of said provisions.

LXX.

The said court erred in refusing to adopt Paragraph XIII of said provisions.

LXXI.

The said court erred in refusing to adopt Paragraph XIV of said provisions.

LXXII.

The said court erred in refusing to adopt Paragraph XVI of said provisions.

LXXIII.

The said court erred in refusing to adopt Paragraph XVIII of said provisions.

LXXIV.

The said court erred in refusing to adopt Paragraph XIX of said provisions.

LXXV.

The said court erred in directing a sale of the said lands and premises before the validity of the said bonds was finally passed upon and determined, and in failing to suspend the sale until the prosecution of an appeal might be had from its judgment.

LXXVI.

The said court erred in confirming the order entered July 28, 1914, permitting and directing the sale of the property of said bankrupt.

LXXVII.

The said court erred in confirming in part the report, Findings, Conclusions and Judgment of the Referee entered July 20, 1914.

EXPLANATION OF SPECIFICATIONS OF ERROR.

The referee made a number of Findings of Fact and a number of Conclusions of Law. Exceptions were filed to practically all of these Findings, in many cases, because of inaccuraces. In the petition for review there were enumerated and set out the errors alleged to have been committed by the referee. These specifications in the petition for review were directed to the same errors to which the exceptions to the Findings and Conclusions and order of the referee were directed. The District Court would not take up and consider and pass upon, separately, the exceptions taken

to the Findings of Fact, Conclusions of Law and order of the referee, and refused to consider, separately the errors charged in the petition for review, but went direct to the testimony and considered the case *de novo*. It also refused to make Findings of Fact and Conclusions of Law, but rendered a judgment holding certain bonds valid and others invalid. To get before the District Court in a concrete and definite way the decree provisions for which it contended, the Washington Trust Company proposed a decree containing provisions in reference to the bonds of each particular holder so that any taint existing against the bonds of one holder would not be imparted any other bonds. Written exceptions were taken to the parts of the decree of the District Court which we contend were erroneous and also a separate exception was taken to the court's refusal to adopt each provision in the proposed decree. These last exceptions sought, of course, to preserve the same points that were raised by the exceptions addressed to the report of the referee and also the same points which were set forth in the petition for review. Out of an abundance of precaution, and at the expense of repetition, we have separately claimed, in our specifications of errors set forth above, as error the court's refusal to sustain each of our exceptions to the referee's report, also his refusal to sustain each of the grounds set out in the petition for review as well as and in addition thereto specification of errors based upon the action of the District Judge in dealing with the subject

matter of the suit so that many of the specifications of error set forth above seek to correct the same mistake, and in our argument we will group together the specifications of error which point to the same subject matter.

ARGUMENT.

$22,900. BONDS HELD BY BANK OF MONTREAL.

The specifications of error raising the question of the validity of the bonds first acquired by the Bank of Montreal amounting to the sum of $22,900. are as follows: 1, 12, 13, 15, 16, 19, 23, 24, 26, 27, 29, 66, 67, 70, 71, 74.

These specifications cover the errors claimed to have been made by the referee and brought to the District Court by petition for review, the errors claimed to have been made by the court in refusing to specifically and separately consider and sustain such exceptions, the court's ruling upon these bonds independent of the exceptions and *de novo* from a review of the testimony and to the court's refusal to adopt the provisions of the decree proposed by the Washington Trust Company. They all, however, relate to the one question, the validity of these bonds, especially in the hands of the Bank of Montreal. The court held these bonds, void. The proposed decree on this point can be found in the Record page 115.

Under this heading we will discuss only the features peculiar to these bonds in the hands of the

Bank of Montreal, and will leave the remainder of the argument and points which pertain to these and other bonds to be discussed under another heading.

In addition to the facts appearing in the opening statement we may add: That the evidence in regard to these bonds shows that the Washington Steel & Bolt Company was short of funds and needed money, and on April 30, 1909, at a meeting of its Board of Directors, duly called, the majority of the board passed a resolution (1) constituting the Bank of Montreal as the depository for the company's funds and transferring its banking business to that bank, (2) authorizing its President, McPhaden, and its Treasurer, Pike, to negotiate such loan as they deemed necessary to further the interests of the company (See Exhibit 31, p. 268). In March or April of 1909 (McPhaden does not remember just when) McPhaden, the President of the Washington Steel & Bolt Company went to the Bank of Montreal to see if he could not negotiate a loan. As the manager of the bank, at that time Mr. Buchanan, (who died before these proceedings were started, p. 220 Record), wanted to know the conditions of the company and the bonds outstanding, McPhaden explained to him the number of the bonds that were out and by whom they were owned. The Bank refused to make the loan unless the bonds were put up as security. McPhaden and Pike agreed that their bonds might be put up as collateral, and the manager of the Bank, after going

to Edmonds to see the plant, agreed to advance the Washington Steel & Bolt Company $20,000 as a loan, taking $22,900 in bonds as security and other security which the evidence shows to be worthless.

On May 1, 1909, the bank advanced the company $10,000; on May 11, 1909, $5,000; on June 16, 1909, $2,500 and on July 28, 1909, $2,500, making a total of $20,000 (See Exhibits 22, 23, 24 and 25 and pp. 219 and 232 Record). The loan was made directly to the Washington Steel & Bolt Company and every cent was used and spent by the Company in its business. (See testimony of McPhaden p. 178 and Ambrose p. 218). The journal and cash book of the company were identified by Barbour, the book-keeper, and introduced in evidence. They show the dates on which these various amounts were received by the Washington Steel & Bolt Company from the bank, and further show that all of this amount was expended by the company. (See testimony of Barbour p. 189 and 190.) The transaction was had in the ordinary course of business of the bank and the money was loaned only upon the faith of the bonds as collateral security. The Washington Steel & Bolt Company not only passed a resolution through its Board of Directors authorizing the President and Secretary to negotiate the loan, but it later ratified the loan and acknowledged it by authorizing the placing of $25,000 of its own bonds as collateral to the loan by the resolution of its Board of Directors on March 20, 1911 (See Exhibit 37). The loan was regular in

all respects and there is not a shred of evidence in the record to the contrary, nor is it denied by the trustee in bankruptcy that the Washington Steel & Bolt Company received the money and used it for its corporate purposes.

Of these $22,900 bonds, $20,000 belonged to McPhaden individually and $2,900 to Pike. They were later presented by the bank to the Washington Trust Company and registered in the name of the bank. (See testimony of Webster p. 221.)

We urged in view of this state of facts that it would be contrary to good faith and common justice to permit the bankrupt to challenge the validity of these bonds after it had, through its officers, used them in the procurement of money amounting to practically the par value of the bonds. In this case there can be no question but the bonds passed into the hands of bona fide purchasers for value, who acted upon the faith of representations made by the bankrupt itself. In so offering the bonds and borrowing money thereon the company represented them valuable as securities and should now be estopped from denying it. Were the rule otherwise, it would afford opportunity for the perpetration of the grossest frauds. It might be argued by the respondent and appellee that the bonds in question went from McPhaden indirect to the Bank. It is true that the bonds were McPhaden's and Pike's bonds, but this would not charge the rule. The money was procured for the bankrupt. It was paid by the bank direct to the bankrupt. The bankrupt

received it and expended the money in the ordinary course of its business, and in procuring this money it offered the bonds of McPhaden and Pike as security. That McPhaden was willing that his bonds should be offered would seem immaterial. Another reason why the bankrupt should not be permitted to impeach these bonds, if we were to concede that McPhaden had not a good title, is that when the company transferred the apparent absolute ownership of the bonds to McPhaden, with the apparent power to dispose of them, and stood by, and received money from a third party which is paid in good faith and in reliance on such title the company is estopped from asserting that McPhaden had no title as against this innocent third party. This reasoning would apply whether the bonds in question were negotiable instruments or merely choses in action or even chattels. Another reason why the bankrupt should not be permitted now to question the validity of these bonds in the hands of the Bank of Montreal is that the facts in this case present a proper case for the application of the legal maximum that where one of two innocent parties must sustain a loss by reason of fraud or infirmity of title, such loss shall fall upon the one, if either, whose act has permitted such fraud or who was a party to such infirmity. If there be infirmity or irregularity in the title of these bonds the parties who produced such are the bankrupt itself and MsPhaden, who, together, by

the use of these bonds, procured the money from the present holder.

There is another rule which is equally applicable and sufficient to protect these securities in the hands of the Bank of Montreal, and that is that where there must be a loss (but we are not conceding in this case that the bankrupt will be a loser) through fraud or infirmity, in title, the person who is most free from fault will be protected and the loss must fall upon the persons at fault. It cannot be said in this case that the Bank of Montreal was, in any sense, at fault or that its action in any way assisted to produce the infirmities which the court below found in these bonds and by reason of which they were held invalid.

In the case of *Orleans vs. Platt*, 99 U. S. 676, 25 L. Ed. 404 the court thus states the rule:

"There was a familiar principle applied by the Supreme Court in that case, which has a much stronger application in this, because the town on account of recitals in the bonds can hardly be considered an innocent party; that, where one of two innocent persons must suffer a loss, and one of them has contributed to produce it, the law throws the burden upon him, and not upon the other party. *Hern vs. Nichols*, 1 Salk, 289; *Merchants' Nat. Bank vs. State Nat. Bank*, 10 Wall 604, 19 L. Ed. 1008."

This court applied, *in re Raymond Box Co. et al. State Bank vs. Coats*, 205 Fed. 618, the rule that where money is received and used for the benefit of a corporation by its executive officers who are also its trustees, the corporation ratifies the con-

tract under which the money was paid and is estopped from denying the authority of its officers to make it. This case is also authority for the following rule, taken from the syllabus:

"2. Persons dealing with corporate agencies have the right to rely upon the apparent authority of those in charge of the corporate business, and for acts done within the scope of that authority the corporation is bound."

These two principles there announced equally well apply to the facts in the case before the court. The bonds were the contracts of the company, and they were used by the corporate agencies of the company who had apparent authority to use them and the corporation received the benefits of the contract. These rules announced by this court in the above case are also sustained by the authority of this state.

Kinkade vs. Witherop, 29 Wash. 10, 69 Pac. 399.

Kirwin vs. Wash. Match Co., 37 Wash. 285, 79 Pac. 928.

Kirsch vs. Interstate Fisheries, 39 Wash. 381, 81 Pac. 855.

Parker vs. Hill, 68 Wash. 134, 146, 122 Pac. 618, 623.

The question of negotiability and the question of the equities claimed to have existed apply alike to these and other bonds, and will be discussed elsewhere in the brief.

BONDS HELD BY BANK OF MONTREAL IN THE SUM OF $25,000. PLEDGED AS ADDITIONAL SECURITY.

The specifications of error addressed to these bonds are 2, 3, 18, 19, 24, 25, 26, 27, 28, 29, 68 and 69.

As we have stated before interest having became due and being unpaid on the loan, and an overdraft existing, the bank, feeling that it was not sufficiently secured, required more security and the bankrupt (Record, p. 275) pursuant to a resolution duly passed by the Board of Trustees, and certified and deposited with the bank bonds in the sum of $25,0000 as collateral security to that loan, in addition to tohose pledeged by McPhaden and Pike, individually. The court below held these bonds void for the reason, as assigned by the court, that they were delivered without authority of the bankrupt, and contrary to the purpose for which they were intended.

We urge that these reasons are not founded upon the evidence nor consistent with the law applicable. The minute book of the corporation had been stolen (pp. 192 and 193). A true copy of the minute book had been made up, or procured, and was in the possession of the bankrupt at the time the trustee was appointed (p. 193). At the time of the trial, the bankrupt refused to produce it, and it could not be found (p. 192), and secondary evidence was offered to show the action upon this point and shows that the resolution passed by the

Board of Directors authorizing the delivery of $25,000 of these bonds as additional security to the Bank of Montreal was passed March 20, 1911, and bears the signature of five of the trustees of the corporation who acted at that time. (See Exhibit 37, Record p. 275.) At that time interest had remained unpaid upon the loan since March 1, 1910, and the interest upon the bonds became due and unpaid on March 1, 1911, twenty days before the delivery of this additional security. The evidence shows that Hadley, acting for Gunn, who was attempting to reorganize the company and put it on its feet, paid the bank interest due from March 1, 1910 up to September 23, 1910, after the company went into bankruptcy. (See pp. 227 to 231 inclusive.) So that these bonds were pledged with the bank, not only as additional collateral security to the loan but to secure an extension of time on the interest due on the notes in the hands of the bank, as well as interest upon the bonds already held by them and to further secure an overdraft of the company.

We contend that this resolution was duly and regularly passed by the Board of Directors. The court at one time held these bonds valid. (See pp. 48 and 49 Record.) It is true that two of the directors whose names appear upon the resolution were not present at the meeting but at least three of them, a majority, were present at the time it was passed. W. R. Ammon, one of the trustees, testifies in the first part of his testimony on direct

examination by the trustee in bankruptcy that he signed the resolution of March 20th in the office of the company at Edmonds but that Pike was not present when he signed it, and that the board sitting as a board did not pass the resolution (p. 204). But on being cross-examined, he states that he remembers very litle about it; that he never signed any statement purporting to be a resolution that was false, to trick the Bank of Montreal or anyone else; that he never signed anything blindly not knowing about it, and that as a matter of fact he does not remember very much about what he did as an officer of the company (pp. 205 and 206). The resolution itself (exhibit 37, p. 275) recites that the meeting was regularly called on notice, and that Ammon, Hall and Pike were present; that the motion was put by Pike and seconded by Hall and carried, and that the motion was put by Pike to send a copy of the minutes to Crosford and Ready for their consideration (they not being present). Ammon testified that there were five directors at this time (p. 205), and to the same effect in the testimony of Pike (p. 195), and to the same effect is the testimony of Hall (p. 210). Hall testified that the trustees in Edmonds, which is a small town, saw each other constantly, almost daily and discussed the matters of the company; that he never signed a resolution which had not been discussed between them, the trustees Pike, Ammon, and himself, and that had been agreed upon that it was the best thing for the company; that on the

occasion on which he signed the resolution of March 20th Amomn was there, but he "did not think Mr. Pike was there"; but that this was several years ago and that he kept no record of it; that he could recall going to a meeting, but could not say what meeting it was; that he did not to his knowledge subscribe to any resolution which was false, that sometimes resolutions after a meeting at the office would be written up and sent to them to sign or ratify what they voted at the meeting (pp. 209 to 214). Pike testifies that both he, Ammon and Hall were present at the meeting; that Hall had a quick call over the telephone, an obsteteric case, and left before the minutes were reduced to writing and the resolution was taken up to his house that night to sign; that Mr. Hall seconded the motion; that the minutes were ordinarily written up after the meetings were held and after they were written up they were sent around to have the signatures of the trustees; that as secretary of the company he always endeavored to incorporate in the minutes just what happened at the meetings pp. 195 and 196). The testimony of Pike is more definite than that of Ammon and Hall, who seemingly remembered very little of what took place. It was natural that Pike's memory should be better as he was the secretary of the company, and was more interested in its affairs than either of the other two.

The resolution on its face shows that it was regularly drawn up. Faith and credit were given to it by the Washington Trust Company, which de-

livered the $25,000 of bonds to the bank on the authority of this resolution, and the bank accepted them in good faith and gave the company all the benefit which it sought by the placing of this additional security.

There is always a legal presumption that the acts of a board of directors or trustees are regular until the contrary is shown. The general rule is that the thing required to be done was done as required. *Thompson Corporations*, (2nd Ed.) Sec. 1163 and cases cited by the author.) Failure to make a record of the proceedings at the time does not invalidate them. Indeed, it has been held that no record at all need be made of the proceedings at a corporate meeting, unless expressly required, and, if there is no record, they may be proved by parol. (*Clark and Marshall "Private Corporations*, Sec. 650.) See also *In re Raymond Box Co. et al*, 205 Fed. 618.

"The failure to enter in the books of the corporation, at the time it was adopted, a resolution increasing the amount of the capital stock, does not affect the validity of the increase, as such corporate acts may be proved as well by parol as by written evidence. (*Handley et al. vs. Stutz*, 139 U. S. 417, 11 Sup. Ct. Rep. 530, taken from the syllabus.)

This, it seems to us, disposes of the question of the authority of the officers to dilever the bonds to the Bank of Montreal. This fact was once affirmatively found by the court (pp. 48 and 49).

Neither the bonds nor the mortgage limit the purpose for which they were issued. The provision

touching that point is, "Whereas, the Board of Trustees of the Washington Steel & Bolt Company, deeming it advisable and to the best interests of said company, and being fully empowered by the bylaws of the said Washington Steel & Bolt Company, and acting pursuant thereto, at a meeting duly held for that purpose, on the date hereof, has resolved and determined that for the purposes of promoting the larger success of the said Washington Steel & Bolt Company, that the borrowing of Two Hundred Thousand Dollars ($200,000.00) was necessary and to the best interests of the company as aforesaid, and that such sum be borrowed for it in its behalf and name by the officers and by due action of the trustees (p. 280).

The company was not prohibited from using its bonds as a pledge, and therefore could make such use of them, as the best interests of the company might require. This point was well considered in the case of *in re National Boat & Engine Company, Butterfield vs. Woodman,* 216 Fed. 208, and resolved against the position taken by the district judge. In that case, as in this, bonds of the company were pledged as additional security and the court, in passing upon that point, says:

"There is a stipulation that these bonds for $32,000 were delivered by the officers of the National Boat & Engine Company as collateral security for the debts of Mrs. McCracken and the two banks. The trustee contends that the transfer of these bonds was without consideration; that they were deposited with the banks and with Mrs. McCracken as additional security on antecedent debts,

namely upon the original notes on which Butterfield was liable as indorser; that they were deposited, not for the purpose of furnishing additional capital to the company, or to assist in the purchase of manufacturing products; that their transfer was without authority, and in fraud of the rights of stockholders.

"The proofs show that the bonds were delivered to creditors of the Racine Boat Manufacturing Company more than six months before the bankruptcy of the National Boat & Engine Company, in order to give security to those creditors. If the physical possession of the pledge had been left with the debtor, the burden of proof would have been upon the trustee in bankruptcy. *Barr vs. Reitz*, 53 Pa. 256; *Taney vs. Penn. Bank*, 232 U. S. 174, 181, 34, Sup. Ct. 288, 58 L. Ed. But here the transaction was completed. The creditors have not received the protection from the bonds to which they are entitled. No action is shown in behalf of the National Boat & Engine Company to limit its obligations in so transferring bonds for the protection of the creditors of the old company, whose property had been absorbed by the National Boat & Engine Company. I think Mary E. McCracken, the National Lumbermen's Bank, and the Hackley National Bank are entitled to the security of the $32,000 of bonds of the National Boat & Engine Company. The testimony fails to satisfy me that the pledging of the bonds was for any fraudulent purpose. I sustain the claim of the petitioner. I give him the benefit of the security of these bonds to a dividend out of the proceeds of the assets covered by the lien of the Astor Trust Company mortgage."

In the case of *Curtis vs. Leavitt et al.*, 15 N. Y. 9, the court in its opinion on p. 197, says:

"The contest in the present case is between creditors of the corporation, to whom the twenty-four bonds in question have been pledged as se-

curity for a preexisting debt, and the receiver of the corporation, appointed subsequent to the pledge, and representing the corporation, its stockholders and general creditors: the precise case within all the cases, where a preexisting debt is a valuable consideration for a sale or mortgage made in good faith. I conclude, therefore, that Holford & Co., as pledgees of the twenty-four bonds and purchasers for a valuable consideration, within the eighth section of the title in relation to moneyed corporations."

In the case of *Duncomb et al vs. The New York H. & N. R. R. Co. et al.*, 88 N. Y. 1, the court held that a railroad corporation may pledge its bonds as security for a precedent debt for moneys advanced by the president for the construction or operation of its road.

In *Rawlings vs. New Memphis Gaslight Co.*, 105 Tenn. 268, 60 S. W. 206, it was held that the act of pledging bonds to secure an advance of moneys for the use of the corporation, or to quiet its preexisting creditors, or to secure its accommodation indorsers was not an act *ultra vires*.

In this case the bonds of the company were used as collateral to paper of the company, which had been used sometime prior to raise money for betterments.

The court cites the following cases:

Guano Co. vs. Hunt, 100 Tenn. 89, 42 S. W. 482.

Baxter vs. Washburn, 8 Lea 15.

Hunt vs. New Memphis Gaslight Co., 95 Tenn. 136, 31 S. W. 1006.

Sanford Fork and Tool Co. vs. Howe, 157 U. S. 312, 15 Sup. Ct. 621.

The last case above cited was somewhat similar to the facts in the present case. There a comparatively young corporation required large sums of money to enable it to carry on its business, and to obtain this executed its 10 promissory notes for $69,000 which notes were endorsed by six directors and stockholders of the company. All the money received from these notes went directly into the company. As the notes thus endorsed began to mature the directors found that the company could not meet them, and the company, at a meeting of its stockholders, authorized a mortgage to be executed to secure any new indebtedness that might be incurred or the renewal or extension of any present indebtedness or liability of the corporation.

This was clearly an execution of a mortgage to secure a pre-existing indebtedness and the court held it a valid execution of the powers of a private active corporation.

In the case of *Hunt vs. New Memphis, supra,* the bonds were pledged to secure preexisting debts due the directors of the company. Held not to be *ultra vires.*

Other cases in point are:

Chick vs. Fuller, 114 Fed. 22, 51 C. C. A. 648.

Coler vs. Allen, 9th Circuit, 114 Fed. 609, 52 C. C. A. 389.

Damarin vs. Iron Co., 47 Ohio St. 581, 26 N. E. 37.

Gould vs. Little Rock, etc., 52 Fed. 680.

The latter is mentioned approvingly in *Sutton Mfg. Co. vs. Hutchinson*, 63 Fed. 496; 11 C. C. A. 320. The case is exactly in point, except that in the present case the corporation was a going concern and in no way insolvent at the time additional security was given, while in that case the company was in failing circumstances.

The following authorities also sustain view that a valid pledge of bonds may be made for the antecedent debt of a corporation:

Thompson Corp. (2nd Ed.) Sec. 2301.

Lehman Bros. vs. Tallahasse, etc., 64 Ala. 567.

Grand Rapids, etc. vs. Sanders, 54 How. Pr. (N. Y.) 214.

Regents etc. Iron Works Co., In re 45 L. J. Ch. 620.

The weight of authority is to effect that a corporation may pledge its bonds for a debt that is less than the face value of the bonds.

Thompson Corp. (2nd Ed.) Sec. 2301.

THE BONDS AMOUNTING TO $1,500 OF C. F. CHAPIN AND THE BONDS HELD BY THOS. F. BURLEY REJECTED BY THE COURT AS VOID, AND ALSO THE PRECEDING BONDS HELD BY THE BANK OF MONTREAL.

Many of the principles of law noticed under this heading are applicable, and we contend should be applied also to the bonds held by the Bank of Montreal, but as they pertain to all the bonds

alike we discuss them here to avoid repetition, and in doing so, we will, of course, discuss the assignments of error before pointed out. The specifications of error, particularly referring to the validity of the bonds of C. F. Chapin are 3, 17, 23, 24, 26, 27, 28, 29 and 72. The specifications of error specifically referring to the bonds held by Thos. F. Burley are 4, 17, 23, 24, 27, 28 and 29. The court rejected these bonds because it believed that they constituted a part of the $23,000 in bonds first issued to McPhaden. The reasons assigned by the court for the rejection of these bonds is that they were for a past consideration and sold for 90c on the dollar.

The evidence shows that C. F. Chapin purchased first $1,500 of bonds from McPhaden shortly after they were issued in 1908, and paid McPhaden $1,350 for them, being 90 per cent of their par value. On April 2, 1909, he purchased two $500 bonds of E. M. Gallant in a transaction in which he considered he paid par value. (See p. 214.) Chapin therefore held $2,500 of the bonds, $1,000 only of which have been held good. Thos. S. Burley purchased his $2,600 of bonds from McPhaden, also shortly after they were issued in 1908. (P. 175.) Meta McElroy (Mrs. Siewart) purchased $1,500 of the bonds held by her from McPhaden, on September 26, 1908, shortly after they were issued. She later purchased $500 of bonds from L. R. Van de Bogart, on June 16, 1909, making a total of $2,000 (p. 217 and Exhibits 7

and 8, p.— Record). Jacob H. Osborne purchased his $7,000 from McPhaden sometime in the fall of 1909 (p. 226). Interest was paid by the company upon the bonds held by these parties up to March 1, 1911, since which date no interest has been paid (pp. 223 and 224).

We believe there can be no contention made on the evidence in this case that either the Bank of Montreal, C. F. Chapin or Thos. S. Burley had any actual knowledge or notice of the provisions of the trust deed, or that they had any actual notice of the fact that the bonds netted the company but 90c on the dollar, nor do we think that any claim can be made that these bonds were not acquired by these people in the ordinary course of business for value, without notice, and if they are negotiable bonds, these parties took them free of all equitable defenses.

Our contentions in regard to the bonds held by these parties are:

FIRST: That the bonds were negotiable and hence passed free of all equities or defenses.

SECOND: That no equities or defenses existed against them which would defeat their enforcement, even if non-negotiable.

THIRD: That the company is estopped from challenging their validity in the hands of the present holders.

THE BONDS ARE NEGOTIABLE AND HENCE TAKEN FREE OF ALL EQUITABLE DEFENSES.

We contend here, as we contended in the court below, that the bonds in question are negotiable bonds. We set out in the opening statement the features showing that each bond was a solemn admission of indebtedness under the seal of the company, bearing all the insignia of negotiable commercial paper, and each bond was one of a series which was intended to be sold in the markets of the world, so we are not dealing in this case with a single obligation between two individuals, nor an isolated bond of a corporation executed to secure the performance of a contract, or do some specific act, but it is a case of a corporation issuing 750 bonds totaling in amount the sum of $200,000 for the express purpose, as stated in the bonds themselves, of putting them on the market for sale to the public in order to raise money. The District Court was of the opinion that the bonds were negotiable and that the bankrupt should not be permitted to set up, as against innocent purchasers for value, any infirmity that might have existed as against the original holder. The opinion of the district judge in this respect was changed, however, by the rendering of an opinion by the State Supreme Court in the case of *Bright vs. Offield*, 143 Pac. 159. The court held in that case that a note requiring the maker to pay taxes upon the note itself and the mortgaged property which secured

the note was not negotiable because it did not conform to Sec. 3392 of the State Code, which requires that a promissory note, to be negotiable, must be an unconditional promise or order to pay a sum certain in money, entertaining a view that the coveant to pay taxes rendered the amount to be paid uncertain. In that case it was an isolated note and not one of a general bond issue, and second, the note in that case required, by the construction placed upon it by the State Court, the maker to pay all taxes which might be assessed against the note and the property securing the note, while in the present case the bonds in question are members of a series intended to be negotiated, and sold in markets distant from the place of record of the mortgage and contain no clause requiring the maker of the bonds to pay taxes upon the bonds thesmelves or the debt represented thereby. By reference to the language of the bond, it will be seen that the provision in reference to taxes is as follows, "All payments upon this bond, both principal and interest, shall be made without any deduction for any tax or taxes that said Washington Steel & Bolt Company may be required to pay or to retain therefrom by any present or future laws of the United States of America or of the State of Washington, said Washington Steel & Bolt Company hereby covenanting and agreeing to pay any and all such taxes."

By observing this provision it will be seen that there is no covenant that the maker of the bonds is required to pay taxes on the bonds themselves.

This tax would naturally be assessed against and paid by the holder of the bonds, in the event of any tax being levied on the bonds. The Washington Steel & Bolt Company simply agrees not to withhold from the owners of the bonds sums which it may be legally required to pay. It agrees to pay any tax which the government or the state may impose upon it, the Washington Steel & Bolt Company, or may require the company to retain when the bonds are paid, should there by chance be any such requirement. It does not agree to pay any taxes which may be imposed upon the various holders of these bonds or upon the bonds. The paper goes forth burdened with no such agreement. The agreement or promise could have been omitted and the same obligation would have rested upon the corporation. But whether in or out, the promise in no way increases, diminishes or modifies the amount to be paid on the bond, which at all times remains certain and fixed. It in no way varies, increases or diminishes the conditions of the obligation of the parties. The stipulation is mere surplusage and should be treated as such. You might say it was a gratuitous expression on the part of the Washington Steel & Bolt Company to do that which the law already obligated it to do.

In the case of *Murray vs. Charleston*, 96 U. S. 432, 24 L. Ed. 716, the City of Charleston attempted to retain out of the interest due on its city bonds a certain percentage, representing taxes due on personal property and the Supreme Court of the United

States denied it the right to retain any amount whatsoever on account of the bonds or the interest due hereon.

To do that which the law already requires or obligates one to do is not an additional obligation or liability. Suppose the note read otherwise and stated that the Washington Steel & Bolt Company would pay the amount named therein less payments which it may be required to make for taxes or to retain therefrom by any present or future law, this language would in that event have rendered the amount of the bond uncertain. In fact the agreement or the assurances that it will not withhold any such sums adds to the certainty of the amount rather than detracting from it. But it is our contention that it does neither. Suppose that the company failed or refused to pay any taxes assessed against it, the company, would this in any way accelerate the maturity of the note? There is no such condition in the bond. Would the happening of that event give any holder of the bond a right of action of any nature against the company? The obligation is to pay the state or the government. No action thereon accrues to the holder of the bond.

The rule is that if the additional stipulation does not change the promise from one to pay the sum absolutely, and at all events, and is independent of that obligation, and does not change the nature of the conditions of the contract, or accellerate the

maturity of the note, it will not render it non-negotiable.

Cherry vs. Sprague, 187 Mass. 113, 67 L. R. A. 33.

Hotchkiss vs. Nat. Shoe & Leather Bank, 21 Wall 354; 22 L. Ed. 645.

In the case of *Bright vs. Offield, supra*, relied upon by respondent and appellee, there was inserted a promise to pay taxes on the mortgaged property securing the note, and taxes on the note itself, with the condition that in the event of the maker's permitting the taxes to become delinquent the entire amount should become due and payable. The court held that both the amount and date of payment were uncertain. The two cases are entirely different. The amount due and the date of payment in the Offield case were based upon certain contingencies, which made both the amount and date uncertain. The note in that case further provided, "if the maker * * * shall do any act whereby the value of said property shall be impaired" the whole amount shall at onece become due and payable and the mortgagee may proceed at once to collect the note and foreclose the mortgage. The bonds in the present case go forth burdened with no such conditions or contingencies. In the Offield case the transaction was an isolated note, where as in the present case the bond is one of a series of bonds intended to be placed upon the market precisely for negotiable purposes. It bears all of the essential requisities of negotiability. It

contains an unconditional promise to pay a sum certain in money. It is made payable to bearer, or in case it is registered to the registered holder thereof. Both the principal and interest due thereon is payable at a fixed future time, and it is in writing and signed by the maker. The stipulation in question in no way varies, alters, or modifies in the slightest the above requisities of negotiability.

Whatever may be the holding in the Offield case, supra, this court is in no way bound by that decision. In the case of *Swift vs. Tyson*, 16 Peters 1; 10 L. Ed. 865, the Supreme Court of the United Shtates holds that in questions of general commercial law the state tribunals "cannot furnish positive rules or conclusive authority, by which our own judgments are to be bound up and governed. The law respecting negotiable instruments may be truly declared in the language of Cicero, adopted by Lord Mansfield in *Luke vs. Lyde* (2 Burr R. 883) to be in a great measure not the law of a single country only, but of the commercial world."

THERE WERE NO EQUITABLE DEFENSES SHOWN TO EXIST AGAINST THESE BONDS, WHICH WOULD DEFEAT THEIR ENFORCEMENT EVEN IF NON-NEGOTIABLE.

If this court should conclude that the bonds are non-negotiable and subject to the equitable defenses on behalf of the maker, we urge that they are still valid obligations. The court below held the

bonds void because it was of the opinion that they were issued by the maker for the past consideration and sold at 90c on the dollar, which was below the minimum price named in the mortgage. We urge upon the court that the testimony does not warrant the trial court in reaching the conclusion that the bonds were issued for a past consideration. Both McPhaden and Pike were paying money into the company to meet its needs, expecting the bonds to be issued, and it was not necessary for the money and bonds to pass at the same amount. If it were conceded that the bonds were delivered to McPhaden and Pike in the first instance for a past consideration, it cannot be urged against the present holder, the Bank of Montreal, because as between the company and the bank there was a present passing consideration. It advanced money upon the faith and credit of the bonds as collateral. But conceding, for the purpose of argument, that the consideration between the bankrupt and the original holder of these bonds was a past consideration, it was still a sufficient consideration for the passing of the bonds:

Sec. 3416 of Vol. 2 of Rem. & Bal. Ann. Codes and Statutes of the State of Washington reads as follows:

"Sec. 3416. Value, what constitutes. Value is any consideration sufficient to support a simple contract. An antecedent or preexisting debt constitutes value; and is deemed such whether the instrument is payable on demand or at a future time." (L'99 p. 346, Sec. 25.) This statute was in

force at the time of the execution of the bonds in question.

Our own state court, as well as courts generally, has held a past consideration sufficient:

Spencer vs. Alki Point Transportation Co., 53 Wash. 77, 101 Pac. 509, 131 Amer. St. R. 1053.

See also 7 Cyc. 696, 705.

Neither does the fact that the bonds were delivered for 90c upon the dollar render them void. The company admits receiving 90c on the dollar for these bonds from the original holder, and it obtained $20,000 in addition from the Bank of Montreal upon the faith of the bonds first delivered to it, and yet the company has the affrontal to come into a court of equity and urge as a complete defense, against the holders of the bonds, that it received no adequate consideration therefor.

The resolution of the Board of Directors of September 1, 1908, authorized the allowance of a commission of 5 per cent of the face value of the bonds to any agent, officer or trustee of the company purchasing or selling any of the said bonds, and further approved the accounts of McPhaden and Pike with the Washington Steel & Bolt Company and directed that the trustee he instructed to deliver them bonds at a discount of 5 per cent and allowing them a commission of 5 per cent for selling them. (Exhibit 27.) (See also Exhibits 28, 29 and 31.)

The testimony clearly shows that both McPhedan and Pike were allowed for the taking of

these bonds the same commission which the company would have been required to pay had the bonds been sold to strangers through them, and the cases are uniform in holding that deductions from the minimum price fixed for the sale of bonds, for commissions, costs of printing, traveling expenses or other expenses incident to the sale of the bonds are legitimate and proper deductions therefrom. The courts recognize, as they must, that it costs money to sell bonds whether it is paid in the way of commissions or in the way of salary, or under the guise of incidental expenses, and this does not invalidate the bonds. If the court, however, should reach the conclusion that these officers should not be entitled to a commission of 5 per cent or to a discount of 10 per cent upon the bonds, it is not a defense under the statutes of this state, or the rule laid down by the Supreme Court of this state, but it is only a *pro tante* defense, and even the original holders would be entitled to a judgment against the company for the amount which they paid for the bonds with interest thereon.

Sec. 3419 Vol. 2 Rem. & Bal. Anno. Codes and Stat. of Wash., reads:

"Sec. 3419. Lack of consideration as a defense, absence or failure of consideration is matter of defense as against any person not a holder in due course; a partial failure of consideration is a defense *pro tanto*, whether the failure to ascertained and liquidated amount or otherwise." (L'99, p. 346, Sec. 28).

Bayview Brewing Co. vs. Techlenberg, 19 Wash. 469, 53 Pac. 724.

Hansen vs. Thomplins, 2 Wash. 508, 27 Pac. 73.

In the case of *Kinkade vs. Witherop*, 29 Wash. 10, 69 Pac. 399, is found a case very similar to the one at bar, and the court holds that the bonds which were given in payment of contractor's claim at the rate of 90c on the dollar were valid. To show the similarity of that case to this, we quote from page 17 as follows:

"These bonds the appellant claims were illegally issued, and do not constitute an indebtedness of the district. The objections urged against them are that there was no consideration for their issue, that they were not paid for in cash, that they provided for the payment of more interest than the statute permitted, and that they are not negotiable in form. That the bonds were issued to Costello for an indebtedness of $18,300 actually due him from the district abundantly appears from the record, and we cannot see how it can be said that there was no consideration for their issue. If the statute contemplated or required a sale for cash, we think the transaction between the parties amounted to that. The bonds had been contracted to Clough & Graves and were to be delivered to them when they paid to the district the purchase price agreed upon. If Costello had paid Clough & Graves $18,300 for the $20,000 worth of bonds received by him, and Clough & Graves had paid this sum to the district, and the district had again paid it out to Costello, the transaction would have been admittedly legal. But the actual transaction betwen the parties amounted to that. Costello had a right to purchase the bonds from Clough & Graves. Clough & Graves owed the district and the district owed Costello. If the parties chose to satisfy these mutual obligations by transferring the bonds, certainly it was not necessary to the legality of the

transaction that they actually pass the money between them."

These statutes and the above decisions seem to resolve the matter of consideration, whether the court finds that it is past or partial, in favor of the appellant.

ESTOPPEL.

We next contend that the bankrupt is estopped from interposing defenses to the bonds in question, which it seeks to interpose, and this estoppel applies to all the bonds alike. This contention, we assume, would be useful to us only in the event that this court should hold the bonds to be non-negotiable instruments. Much that we have said bearing upon this point concerning the bonds held by the Bank of Montreal is applicable to all other bonds, and much that is said here is applicable to those bonds.

With the substance of the bonds in mind, as shown by the opening statement, it must be conceded that if the bonds are not negotiable it is because of their technical wording and not because they were so designed or dealt with, and the hidden technicality is such as would not have been discovered by the ordinary dealer in bonds. The bonds have all the appearances of negotiable paper and passed by delivery. Further, the Washington Steel & Bolt Company, in closing each bond witnesses upon its face that it was signed and executed and the corporate seal affixed, "pursuant to legal authority in them vested to that end." The mortgage

is pregnant with recitals of corporate action fully justifying the issuance of the bonds. In this form the bonds were given out and sold to investors for money or other valuable consideration. The purchasers of these bonds registered their holdings without complaint being made, and the company issuing the bonds, in recognition of their liability thereon, paid at least two years interest.

Even if there were fatal equities, which we do not concede, existing between McPhaden and the bankrupt, they should not avail against the present holders of the bonds. These bonds, although they be held not technically negotiable, have acquired in the course of business custom a semi-negotiable character. The bankrupt, in passing the bonds to McPhaden, conferred upon him the apparent absolute ownership with apparent power to sell and convey a good title, and we believe the rule to be that where the owner of non-negotiable commercial paper has assigned or delivered it to another in the method commonly employed by all mercantile communities for such transfers, or in the method stated upon the face of the instruments for such transfer, he thereby clothes such other with such apparent insignia of title and complete ownership as will estop him as owner from setting up equities against purchasers in good faith for value. That is, such a person cannot, in an action upon such securities, urge the fact that the title was not absolute and perfect in the person to whom the securities had been thus assigned or delivered. If this were not so,

a corporation would be afforded a convenient way of escape in all cases where its own negligence or carelessness or unbusinesslike dealing with its internal affairs had misled others into the purchase of its own securities.

Aside from but kindred to the matter of estoppel we urge that the trustee in bankruptcy is in this action going counter to the well known principle that one cannot plead his own wrong to relieve himself from the obligation of an executed contract whose benefits he has retained, and also the rule that he who comes into equity must come in with clean hands and he who seeks equity must do equity.

In the case of *Sioux City Terminal R. & W. Co. vs. Trust Co. of N. A.*, 82 Fed. 124; 27 C. C. A. 73, the court, in its syllabus, says:

"A mortgage given by a corporation to secure a debt in excess of the amount of indebtedness which it had power under the statute to contract is binding on the corporation and its subsequent creditors, where the corporation has received the full consideration for the debt secured, and the transactions were free from fraud."

"After a corporation has negotiated and received the proceeds of bonds secured by a mortgage executed by its officers, sealed with its corporate seal, and reciting that it was executed by authority of the corporation, both the corporation and its subsequent creditors are estopped from denying the validity of the mortgage because its execution was not authorized by a proper resolution of its Board of Directors."

In discussing facts similar to the one at bar the court in that case (p. 134), says:

"The corporation does not offer to return the moneys which it received upon this mortgage, but seeks to retain all its benefits and to repudiate all its burdens. It will be soon enough for the chancellor to stay his hands from the enforcement of these contracts and soon enough for him to set them aside, when the corporation returns to the complainant the moneys it received upon them. Until then, good faith, justice, and equity demand their enforcement. A man cannot plead his own wrong to relieve himself from the obligations of an executed contract whose benefits he retains," and further, after a view of the authorities the court concludes as follows:

"These decisions do not rest upon the principle of estoppel, nor depend upon the creditors' ignorance of the excessive indebtedness. They stand upon the rule that he who seeks equity must do equity, and upon the principle that one may not at any time accept the benefits and repudiate the burdens of his contracts."

In the case of *Wright vs. Hughes*, 12 Amer. St. Rep. 412 (119 Ind. 324), the court, in dealing with a mortgage given by a corporation to secure the payment of money, announced the doctrine as follows:

"It is not equitable to ask a court of conscience to avoid a mortgage given to secure borrowed money without offering to return the money which has been received. Having received the full benefit of the contract, it would now be a glaring injustice to allow those representing the corporation to set it aside and retain the benefit by sustaining their contention that the loan was *ultra vires;* especially as this doctrine only concerns the corporation in its relations with the state and with its stockholders, and is never entertained where it will injure innocent third persons: *Bissel vs. Michigan Southern, Etc. R. R. Co.*, 22 N. Y. 258."

In the case of the *First Nat. Bank of Hailey vs. G. V. B. Min. Co.*, 89 Fed. 439, the doctrine is announced as follows, quoting from syllabus:

"Where the chief officers of a corporation are in reality its owners, holding nearly all of its stock, and are permitted to manage the business by the directors, who are only interested nominally or to a small extent and are controlled entirely by the officers, the acts of such officers are binding on the corporation, which cannot escape liability as to third persons dealing with it in good faith on the pretense that such acts were *ultra vires*."

In the case of *Bensiek vs. Thomas*, 66 Fed. 104, the court says on page 110 of its opinion, as follows:

"In the case of *Plank-Road Co. vs. Murray*, 15 Ill. 336, the facts were that the directors of the company had borrowed money without authority, and had given a mortgage upon the company's property to secure it. It was held that, inasmuch as the company had received the money, and used it, it was estopped from questioning the authority of the officers who had made the loan. Also, in *Troup's Case*, 29 Beav. 353, 357, it was decided by the master of the rolls that, when the directors of a company have no power to borrow money, a person lending money to the company cannot enforce payment of it against the company, unless it has been *bona fide* applied to the purposes of the company, but that, if so applied, a recovery against the company may be had."

We have not set forth the facts in these cases from which quotations are made because the quotations refer particularly to a doctrine which we ask be applied to the facts in this case. The corporation borrowed money here, has not returned it, has

not offered to return it, but retains all the benefits of the transaction, and yet seeks to repudiate it.

The following cases also support our contention:

Pittsburg C. C. & L. Ry. Co. vs. Lynde, 44 N. E. 596; 55 Ohio St. 23; 172 U. S. 493.

Ind. & Ill. Cent. Ry. Co. vs. Sprague, 103 U. S. 756; 26 L. Ed. 554.

City of Antonio vs. Mehaffy, 96 U. S. 316, 24 L. Ed. 816.

In the case of *Pittsburg C. C. &St. L. Ry. Co. vs. Lynde*, the opinion discloses that Benj. E. Smith was president of the company issuing bonds and as such president he had the custody of the bond issue. Without knowledge or consent of, or authority from the Board of Trustees and without consideration moving to the company Smith negotiated and pledged certain of the bonds, for his private use. It was claimed that the bonds which were thus pledged were not negotiable instruments and did carry with them protection to innocent purchasers for value. The court, in dealing with the matter and treating it independently of the question whether or not the bonds were negotiable, said:

"Independently of the rule of law designed to protect and give currency to negotiable paper, those principles of natural justice universally applicable to the affairs of mankind, when applied to this transaction, would seem to demand the protection of the defendant in error as against the maker of the bonds and all who stand in its shoes. He was wholly free from fault in connection with the transaction. Each bond contained a declaration of its transmissibility from hand to hand by mere de-

livery. He found them for sale before they were due in the market where such securities are usually offered for sale and bought them at their fair market value, without notice of any infirmity in their title. Soon thereafter he took them to the Union Trust Company, in New York City, the agents of the maker especially appointed to register its bonds, and caused them to be registered in his name on its books. What more could even the highest degree of prudence or diligence demand of him? On the other hand, the maker of the bonds, a railway company, capable of acting through agents only, placed these bonds in the custody of its president, an agent clothed with high, though possibly not clearly defined, powers. The bonds were perfect obligations, bearing on their face a certificate of authentication by the trustee, and containing an express declaration of their transmissibility from hand to hand by mere delivery. He was, up to and long after the time these bonds were negotiated, continued as president of the different consolidated companies as they were successively formed. The companies thus held him out to the world as one who could be trusted to transact matters of importance. Under these circumstances, what can be found tending to excite a doubt in the most cautious mind respecting his power to dispose of bonds so intrusted to him? If the maker of these bonds and those who must abide by their title can shift the responsibility and consequent loss resulting from this transaction from themselves to the holder of the bonds, it must be by the application of some stern rule of law founded upon considerations of public policy."

In *Ind. & Cent. Ry. Co. vs. Sprague, supra,* the supreme court of the United States says:

"The bonds for the payment of money with interest warrants attached are everywhere encouraged as safe and convenient mediums for the settlement of balances among the mercantile men and any course of judicial decisions calculated to re-

strain or impede their free and unembarrassed circulation would be contrary to the soundest principles of public policy."

Guided by this principle, the Supreme Court protected bonds in the hands of an innocent purchaser who took them from the president of the company issuing the bonds, although the president did not own the bonds and had no authority to dispose of them.

In the case of *City of Antonio vs. Mehaffy* there was involved city warrants or certificates. The city was sued upon these certificates by an innocent purchaser for value. The city defended upon the ground that it had no statutory authority to issue such certificates, and that they were not negotiable. The court in passing upon the question said:

"The city is estopped by the recital on the face of the securities to deny its verity. A *bona fide* purchaser had a right to regard it as true, and was not bound to look further. *Comrs. vs. Aspinwall*, 21 How. 539 (62 U. S. XVI., 208); *Mercer Co. vs. Hacket*, 1 Wall. 83 (68 U. S. XXI., 548); *Grand Chute vs. Winegar*, 15 Wall. 355 (82 U. S. XXI., 170); *San Antonio vs. Gould* (*supra*)."

"The principal securities delivered to the company were not bonds, because they were unsealed; but this is immaterial. The twelfth section, under which they were issued, expressly declared that those charged with the duty of subscribing "May issue bonds bearing interest, or otherwise pledge the faith of the city."

"The securities issued were within the latter category. If that clause were wanting, we should have no difficulty in holding that the city was, under the circumstances, estopped from denying their validity. The doctrine of *ultra vires*, whether invoked

for or against a corporation, is not favored in the law. It should never be applied where it will defeat the ends of justice, if such a result can be avoided. *Whatney Arms Co. vs. Barlow*, 63 N. Y. 62.

In the case of *Wesson vs. Town of Mt. Vernon*, 98 Fed. 804-808, the court, in quoting on the question of estoppel from *Hackett vs. Ottawa*, 99 U. S. 86, and other decisions, says as follows:

"The bonds in suit, by their recital of the titles of the ordinances under which they were issued, in effect assured the purchaser that they were to be used for municipal purposes, with the previous sanction, duly given, of a majority of the legal voters of the city. If he would have been bound, under some circumstances, to take notice, at his peril, of the provisions of the ordinances, he was relieved from any responsibility or duty in that regard by reason of the representation, upon the face of the bonds, that the ordinance under which they were issued were ordinances "providing for a loan for municipal purposes." Such a representation by the constituted authorities of the city, under its corporate seal, would naturally avert suspicion of bad faith upon their part, and induce the purchaser to omit an examination of the ordinances themselves. It was, substantially, a declaration by the city, with the consent of a majority of its legal voters, that purchasers need not examine the ordinances, since their title indicated a loan for municipal purposes. The city is therefore estopped, by its own representations, to say, as agains a *bona fide* holder of the bonds, that they were not issued or used for municipal or corporate purposes. It can not now be heard, as against him, to dispute their validity. Had the bonds, upon their face, made no reference whatever to the charter of the city, or recited only those provisions which empow-

ered the council to borrow money upon the credit of the city, and to issue bonds therefor, the liability of the city to him could not be questioned. Much less can it be questioned, in view of the additional recital in the bonds, that they were issued in pursuance of an ordinance providing for a loan for municipal purposes; that is, for purposes authorized by its charter. *Supervisors vs. Schenck*, 5 Wall. 772, 18 L. Ed. 556. It would be the grossest injustice, and in conflict with all the past utterances of this court, to permit the city, having power under some circumstances to issue negotiable securities, to escape liability upon the ground of the falsity of its own representations, made through official agents, and under its corporate seal, as to the purposes with which these bonds were issued. Whether such representations were made inadvertently, or with the intention, by the use of inaccurate titles of ordinances, to avert inquiry as to the real object in issuing the bonds, and thereby facilitate their negotiation in the money markets of the country, in either case the city, both upon principle and authority, is cut off from any such defense."

In the case of *Dorain, Admx. vs. City of Chreveport*, 28 Fed. 287, the court, upon the question of estoppel says (Syllabus):

"Under the power vested by statute in a municipal corporation whereby it may contract for the making of public improvements and issuance of bond the payment for the work performed, a bond was issued for work actually done, becomes a voucher or evidence of indebtedness to that extent and may be recovered upon by the assignee in good faith even though such corporation had never been specifically empowered to issue negotiable paper."

On page 290 the court further says:

"If the ordinance in this case seems to leave something to be effected by suppleemntal ordinances the city alone was able to supply them. Indeed,

the law would be a trap for unwary creditors if she is allowed, in this case, to enjoy all the advantages of her errors, and the plaintiff to be visited by all of the destruction. If the bonds are treated as commercial instruments, the statute (section 2448), would not affect their validity, because the city would be estopped by the recitals in the securities. She would not be allowed to deny the declaration therein made that the law had been complied with. *Louisville, Etc., R. Co. vs. Letson*, 2 How. 539; *Mercer Co. vs. Hacket*, 1 Wall. 83; *Grand Chute vs. Winegar*, 15 Wall. 355; *San Antonio vs. Mehaffy*, 96 U. S. 314."

By an examination of the bonds and the mortgage in this case it will appear that their broad language under the principles announced in the above quotations fully estopped the bankrupt in this case from interposing the defense it is urging to defeat these bonds.

This court, in passing upon a similar statement of facts, and discussing the question of estoppel, in the case of *United States Savings & Loan Company vs. Convent of St. Rose*, 133 Fed. 354, said as follows:

"2. Conceding, for the purpose of this opinion, that the appellee was not authorized to become a shareholder in the stock of appellant for the purpose of securing a loan of money to enable it to build a convent on the land mortgaged, it does not necessarily follow that the court should set aside and annul the contract on that ground. The mortgage in this case was given under and in pursuance of the contract made between the parties. It was an executed contract. Appellant paid $7,000 to appellee, and did everything which it agreed to do. Appellee has received the fruits and benefits of the contract, but has not paid all the money agreed to

be paid thereon by the terms of the written contract. Can it now successfully defeat the contract by the plean of *ultra vires?* It must be remembered that we are called upon to deal directly with the rule as applied to private corporations, where the contract has been fully executed by the party against whom the plea of *ultra vires* is invoked, as distinguished from the rule which is applied to cases of executory contracts or contracts made by public or quasi public corporations, which owe important duties to the public. The general rule applicable to the case in hand is expressed in 5 Thompson on Corporations, Sec. 6016, as follows:

" 'The great mass of judicial authority seems to be to the effect that where a private corporation has entered into a contract in excess of its granted powers, and has received the fruits or benefits of the contract, and an action is brought against it to enforce the obligation on its part, it is estopped from setting up the defense that it had no power to make it.' "

MOTION TO DISMISS.

The Washington Trust Company was in doubt whether the order of the court directing an immediate sale of the property for cash was a "proceeding in bankruptcy," under Section 24b, or a "controversy arising in a bankruptcy proceeding," under Section 24a. It, therefore, brought this cause here on Petition for Review, as well as appeal that the whole matter may properly come before the court and be decided upon the merits in one or both of the proceedings.

The respondent, Mr. Chavelle, has made a Motion to Dismiss the Petition for Review upon the grounds that an appeal is the proper proceed-

ing and the further ground that no certified copy of the record accompanied the petition for review.

It needs but a casual examination into the authorities to conclude that there is considerable confusion in the practice concerning the office of appeal and the office of a Petition for Review, and we understand the practice to be that where there is doubt, the litigate, to insure a full and complete review of all points involved in the controversy, may persue an appeal and at the same time a petition for review, and that the Circuit Court of Appeals will consolidate them, consider both and determine the matters complained of in either or both proceedings, as the case may require. To this effect see:

Collier on Bankruptcy (8th ed), 434, 435, 436.

Lockman vs. Lang et al., 132 Fed. 1.

Fisher vs. Cushman et al., 103 Fed. 860.

In re Worcester County Derby vs. Worcester Co., 102 Fed. 808.

In the last case above cited the court held, syllabus 3, a party who is in doubt as to his right to appeal from an order in bankruptcy, may, in addition to taking an appeal, file a Petition for Review under Section 24b of the Bankruptcy Act, and the Circuit Court of Appeals may determine the matters complained of in either or both proceedings as it shall determine to be appropriate. We believe the above is sufficient authority for the propriety of pursuing a petition for review and also an appeal.

Answering the other ground of the Motion to Dismiss, we call the court's attention to the fact that copies of the orders and proceedings sought to be reviewed were attached to the petition, and that authenticated copies followed later as a part of the record on appeal. The record is lengthy, at most, and the expense of taking this matter to the Circuit Court of Appeals is heavy, and it would have been idle and serve no good purpose to have doubled the record by having a certified copy filed with the Petition for Review, and later have it duplicated in connection with the appeal. We take it the statute does not require the certified copy to be filed the same moment as the petition for review. These matters are, to all intents and purposes, consolidated, argued together and will be determined together, and one record supplies the needs of the court and satisfies the provisions of the statute, so we feel that the motion to dismiss the petition for review should not be granted.

THE SALE OF THE PROPERTY FOR CASH, FREE OF ENCUMBRANCE.

The specifications of error referring to the court confirming the order of sale and refusing the right of the mortgagee to foreclose are contained in Nos. 5, 6, 7, 8, 73, 75 and 76.

The propriety of the court confirming the order of the referee directing an immediate sale of the property for cash, free of encumbrances, is sought to be reviewed by appeal and by Petition

for Review, and this argument is made in support of the appeal as well as the Petition for Review.

The property in question consists of about nine acres of land located at Edmonds, Snohomish County, Washington, and certain machinery which was used in connection with the manufacture of bolts, and the building in which it was situated. The building and machiney have greatly deteriorated, and the evidence introduced upon the trial was predicated upon an area of 25 acres of tide lands when there was about three acres of tide lands.

If the bonds are held valid, as we believe they will be, there will be no equity whatsoever for the general creditors in this property, and the trustee in bankruptcy for creditors could have no interest therein, and in our judgment, has never had any interest in the property because the mortgage indebtedness has always far exceeded its fair market value. The bond holders are the only persons who will be injured by the sacrifice of this property, and the only persons who will be benefitted by its conservation or preservation, and the only way in which they can protect their investment and prevent a sacrifice of it at a forced sale is to be permitted to use their bonds in answering any bid which they might make. So we contend that until the validity of the bonds is determined no sale should be ordered of this property, and further, that when a sale is ordered that the bond holders or this trustee for the bond holders should be permitted to use their bonds in answering their bids.

The trust deed itself permitted and authorized the holders of the bonds to use their bonds at the foreclosure sale of this property. The provisions of the deed relating thereto are as follows:

"It is hereby further covenanted, agreed and declared that in case any sale shall be made of the said Washington Steel & Bolt Company's factory or factories, wharf or wharves, plant or plants, property, rights and privleges, covered or intended to be covered by this indenture, or pursuant to or under a decree of judgment of a court of competent jurisdiction, the purchaser or purchasers at such sale shall after first paying in enough to cover the costs and expenses of the foreclosure suit and sale, and any unpaid compensation or charges of the trustee, and such other charges or expenses of the property pending the foreclosure as the court having jurisdiction of the suit, shall require to be paid in cash, shall have the right and shall be entitled in making settlement for, and in payment of the purchase money, to deliver to the trustee, or in case of a judicial sale to the person or persons legally appointed and qualified to receive the payment of such purchase money, any of the bonds or coupons secured by this indenture held by such purchaser or purchasers, and to use and apply the same in or towards the payment of such purchase money, reckoning and computing the said bonds and coupons at a sum equal to and not exceeding that which would be payable out of the net proceeds of such sale, if made for money to the purchaser or purchasers, as the holder or holders of the said bonds or coupons for his or their just share and proportion, in that character, of such net proceeds upon a due accounting, apportionment and distribution thereof." (See Article V., Trust Deed, p. 304, Record.)

"It is hereby covenanted, agreed and declared that at any sale of the property, plant or plants,

rights or privileges hereby conveyed, whether made by virtue of any power herein granted, or by judicial authority, the trutee upon request of the holders of three-fourths in amount of the said bonds, then outsanding, may bid for and purchase or cause to be bid for and purchased, the same, for and on behalf of all the holders of the bonds hereby secured, and then outstanding, in the proportion of the respective interests of such bond holders, at a price not exceeding the whole amount of such outstanding bonds at the par value thereof, which the interest accrued thereon, and the expenses of such sale." (Article VII., Trust Deed, p. 306.)

The District Court heard the petition for review of the order directing a sale of the property at the same time that it heard the petition for review upon the other branches of the case, and passed upon both at the same time. The court held valid $10,000 of the bonds so at the time the court confirmed the order directing sale of the property there were bonds established as valid, which were liens upon this property, and the court directed that these bonds be paid out of the proceeds of the sale. The Washington Trust Company was not bound under the terms of its trust deed to advance its own money for the purpose of securing a fair bid at the sale, and thereby protect its bond holders, and preventing the sacrifice of the property. The referee refused to permit the bond holders to use their bonds in the purchase of this property. The District Court, however, held some of the bonds valid, and we requested permission to use these bonds in bidding at the sale. This request was denied by the court, and in order to bring the matter fairly to the court's

attention and preserve our exception, we proposed the following provisions, which the court also denied:

These provisions are as follows, to-wit:

21. IT IS FURTHER ORDERED, CONSIDERED, ADJUDGED and DECREED that any holder or holders of the bonds or coupons secured by this mortgage, according to the terms of this decree, if successful as bidder or bidders at said sale, may, after first paying in enough to cover all proper and lawful charges and demands which may be made by the trustee, the Washington Trust Company, including its compensation and the compensation of its attorneys, and also paying in such portion of the expenses of this bankruptcy proceeding as should be paid by the holders of said bonds, use such bonds and coupons to apply toward the payment of the purchase money, reckoning and computing the said bonds and coupons at a sum equal to and not exceeding that which would be payable to such bond holder or holders as such out of the net proceeds of such sale if made for cash.

22. IT IS FURTHER ORDERED, ADJUDGED and DECREED that the Washington Trust Company may, as trustee for the holders of said bonds, with their consent, after first paying in money sufficient to cover such portion of the expenses of this bankruptcy proceeding as should be paid by the bond holders, become a bidder at said sale and may use, in making settlement for and in payment of the purchase money to account to the trustee in bankruptcy, any and all of the bonds or coupons secured by said mortgage and held valid by this decree, and may use and apply the same in and toward the payment of the purchase money reckoning and computing said bonds and coupons at a sum equal to and not exceeding that which would be payable out of the net proceeds of said sale, were the purchase price paid in cash, to the holders of such used bonds.

We charge as error the court's refusal to provide that the bond holders might in some way use their bonds in bidding at the sale.

The bond holders, whose bonds had been declared valid, were entitled, as a matter of right, to have the above provisions inserted in the decree, or have their right to use their bonds protected in some appropriate way. This rule is so well established that authority is not necessary. If they had not this right, very few bond holders or persons loaning money upon mortgages and notes could protect the investments which they had made, and to deny them this right would, in many cases, take from them for a nominal sum their investment. In view of the fact that the principle is so well established, we cite but few authorities in support of the contention:

American Water Works Co. of Illinois vs. Farmers Loan & Trust Co., 73 Fed. 956.

Thompson vs. Prince, 9 Wash. 107; 37 Pac. 291.

The court says, in commenting upon this point in *Thompson vs. Prince*, as follows:

"Counsel for appellant contends that the sheriff has a right to compel the actual payment of the money, but we cannot agree with him. There is no reason why the money should be paid over under such circumstances. Such a requirement would serve no good purpose, and might be productive of serious harm. It might not have been an easy matter for the plaintiff to have raised nearly $60,000 to pay over to the sheriff, even though she was entitled to receive it back immediately, and the fail-

ure to raise it might have resulted in a sale for a much less sum, to the injury of either the plaintiff or the execution defendant, and perhaps, in a measure, to both of them. She had this money invested in this property in effect, and it was to satisfy the same that the sale was decreed."

Payment on foreclosure sale by surrender of bonds secured by the mortgage is regarded in law as payment in money.

Moran ps. Hagerman, 64 F. 499, 12 C. C. A. 239; 159 U. S. 261; 15 Sup. Ct. Rep. 1041.

In the case of *Ketchum vs. Duncan*, 96 U. S. 659; 124 L. Ed. 868, the court said:

"Permission to bond holders who are mortgagees to purchase at a sale of the mortgaged property and to pay by their bonds is not only usual, but it is highly advantageous to all persons who have an interest. It tends to enhance the price which may be obtained, and thus benefits other creditors as well as the mortgagor. That large bond holders have an advantage over small ones, in that they are required to pay less in money, may be true; but it is an advantage they purchased when they obtained their bonds, of which it would be inequitable to deprive them. Such an advantage is everywhere recognized and protected, notably in partition suits, and in sales of the assets of a partnership, as well as in many sheriff's sales."

It is to be observed in the present case that all of the bond holders who are represented by the trustee under the trust deed desire to use their bonds in bidding at the sale.

In the case of *Reed vs. Schmidt*, 115 Ky. 67; 72 S. W. 367; 61 L. R. A. 273, the court said:

"From the enormities of the properties involved, and of the sums necessary to buy them in

at decretal or foreclosure sales, the courts have favored combinations of those inerested in the property as bond holders or stock holders, organized to buy in the properties, for the reason that by this means only are bidders assured, and the best interests of those having claims upon the property protected. *Terbell vs. Lee*, 40 Fed. 40; *Cary vs. Houston & T. C. R. Co.*, 45 Fed. 438; Cook, Corp., Sec. 886 and authorities there cited."

The case of *Sage vs. Central R. R. Co.*, 99 U. S. 334; 25 L. Ed. 394, involved a foreclosure of a mortgage containing provisions to the effect that the trustee in case of a foreclosure could use the bonds in bidding in the property on behalf of the bond holders. We take the followning from the decision of the court:

"The purposes sought to be accomplished by it are manifest:

"First. It was designed for portection against the perils of a forced sale for cash of an unsalable property. It was well known that at judicial sales of railroads for cash there is ilttle likelihood of obtaining a bid for a sum at all commensurate with the value of the property sold, or with the amount of incumbrances upon it. The amount required is so large, usually, that it is beyond the reach of ordinary purchasers.

"The primary object of the deed was to secure to the bondholders a prior right to the entire property—the subject of the trust—so far as it was needed for the full payment of the bonds."

Also in the case of *Jacobs vs. Turpin*, 83 Ill. 423, it was held that where the purchaser is the holder of notes secured by a deed of trust no money need be paid in.

It is therefore the contention of the Washing-

ton Trust Company that the agreement in the deed of trust above referred to permitting the bond holders to use their bonds in payment of the purchase price at the sale should be upheld and the agreement of the parties enforced, as it is not in violation of any statute or law on the subject or contrary to public policy, and prejudices no one. It preserves the rights of the bond holders to their security and gives effect to the intention of the parties. To deprive them of this right would be to deprive them of a portion of the security which the Washington Steel & Bolt Company gave them when they purchased the bonds relying upon the agreements and stipulations therein contained. Such an arrangement in no way prejudices any of the general creditors, but on the contrary will enhance the value of the sale. If the bond holders or the trustee representing them should bid beyond the value of the bonds naturally they would be required to pay the difference in cash. If the bond holders were not permitted to use their bonds and the amount bid in was less than the value of the bonds the entire proceeds would necessarily go to the bond holders to be applied on account of their bonds.

So we contend that until the validity of the bonds has been finally established, as it was understood by the court an appeal would be taken, and the bond holders in postion to protect their investment by using their bonds in bidding for the property, no sale should have been ordered. In no case

should a sale have been ordered without at the same time protecting the rights of those whose bonds had been declared valid, and permitting them to use their bonds in bidding at the sale and making good their bid.

We before quoted from the order of Judge Clinton W. Howard, District Judge, of March 13, 1913, in which he ordered that when the validity of the mortgage and bonds had been determined, the trustee in bankruptcy must elect whether he will administer upon the equity of redemption for the benefit of creditors or surrender the mortgage to the mortgagee for foreclosure. We contend that this became the rule of the case and that the District Judge, instead of ostensibly foreclosing the mortgage himself, that the trustee in bankruptcy should have been required to administer upon the equity of redemption or surrender the property. There is a substantial reason why this should be done as the trustee has persistently held on to this property against the will and wish of the mortgagee or the bond holder, and are in fact holding adversely to them, and must be said to hold the property for the benefit of the general creditors and the lien or the amount of the mortgage should not be impaired nor the security encumbered with expenses incident to such holding. It is easy to see how the trustee in bankruptcy might attempt to assert a claim for a large amount for the care and preservation of this property, and attempt to have the same established as prior to the said mortgage lien.

This appellant and petitioner, for the reasons set for in this brief, asks this court to adjudge the bonds held by the Bank of Montreal, C. F. Chapin and Thos. S. Burley valid obligations of the Washington Steel & Bolt Company, and that there is due thereon the face of the bonds, together with interest from the first day of March, 1911, and that each of the said bonds is secured by the said trust deed, and that the order of sale entered by the said referee and confirmed by the said District Judge be vacated and set aside, and that the Trustee in Bankruptcy, by the decree of this court, required to elect whether he will administer upon the equity of redemption of said property for the benefit of general creditors, or surrender the property, and the whole thereof, for foreclosure, and that this appellant and petitioner have such other and further relief as, in the judgment of the court, may seem meet and equitable.

DANSON, WILLIAMS & DANSON,
JAMES B. MURPHY, and
CARL KINCAID,

Counsel for Appellant and Petitionr,
The Washington Trust Co.